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PENSION BENEFIT FORMULAE FOR SMALL AND MEDIUM SIZED CORPORATE EMPLOYERS

RICHARD L. STILES*

INTRODUCTION

The current proposals before Congress with respect to qualified deferred compensation plans have greatly increased the interest in such plans.[1] In addition the marketing activities of life insurance companies and other organizations which fund pension plans have shown that the installation of such plans is available to the small and medium sized corporate employer without a substantial initial cost. This in turn has directed many attorneys to the subject of deferred compensation plans because of the needs and inquiries of their corporate clients.

This article will explain the basic benefit formulae of pension plans normally used by small and medium sized employers. Benefit formulae under profit sharing plans and other deferred compensation arrangements are beyond the scope of this article. No attempt will be made to define quantitatively a small or medium sized corporate employer. However, the formulae described are more often used by employers having one hundred or less employees than other types of formulae.

The following benefit formulae will be reviewed:

1. Defined Benefit-Not Integrated With Social Security
2. Defined Contribution-Not Integrated with Social Security
3. Plans Integrated With Social Security:
   a. Defined Benefit
   b. Defined Contribution
4. Assumed Retirement Benefit—With Level Annual Contributions

I. DEFINED BENEFIT—NOT INTEGRATED WITH SOCIAL SECURITY

A defined benefit pension plan defines the retirement benefit

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1. Pension Reform Act of 1974, Pub. L. 93-406.

that the employee will receive at retirement. The earliest type used a formula such as: "$100 per month for life," commonly known as a "flat benefit" formula. Under this formula an employee would receive $100 per month for life beginning with the date of his retirement.[2] The employer (assuming advance funding) would contribute a certain amount each year so that at the date of retirement a sufficient sum of money would have been accumulated to provide the benefit so defined. This formula was not widely used for two reasons: (1) It created a benefit which, as related to compensation, was proportionately greater for the low paid employees than for the high paid employees; (2) It could not protect the projected benefit from the erosion of inflation.

In order to offset the disadvantages of the "flat benefit" formula, the "percentage of earnings" formula was developed which created a retirement benefit equal to a certain percentage of an employee's compensation as: "30% of the employee's annual average compensation."[3] If an employee averaged $12,000 per year from the date of participation under the plan to the date of retirement, his retirement benefit would be $3,600 per year.

As a further consideration, the formula could specify that the average compensation selected be based upon the average of the five highest consecutive years of compensation rather than the average compensation of all years of participation in the plan.[4] Known as the "final pay" plan, this modification produces a higher retirement benefit and provides greater protection against inflation.

The "percentage of earnings" formula may be computed on either basic or total compensation. Total compensation would include bonuses, overtime pay, commissions, and other taxable compensation.

The yearly amount which the employer must contribute to produce the benefit as "defined" will depend on the actuarial assumptions used.[5] Such assumptions will usually be provided by the insuring company if any life insurance policies are used under the plan. If no insurance company is involved, the employer will have to obtain such services from an independent actuary or from organizations which administer pension plans. The actuarial assumptions

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2. D. McGILL, FUNDAMENTALS OF PRIVATE PENSIONS at 67 (1968).
3. *Id.*
4. J. MELONE & E. ALLEN, JR., PENSION PLANNING at 38 (1970). [Hereinafter cited as PENSION PLANNING.]
5. *Id.* at 83-95.

will involve projections regarding the rate of return on the funds invested and a mortality rate taken from mortality rate tables. In small plans, mortality assumptions are not used except to the extent that they are reflected in life insurance policies within the plan.[7]

Another "defined benefit" formula, known as a unit benefit pension plan, defines the retirement benefit as a flat amount per year of service or a flat percentage of compensation per year of service. Examples of such formulae are as follows:

> 1. *Flat Amount Per Year of Service:* "A participant's retirement benefit shall be $10 per month for each year of service to the employer." If an employee had thirty years of service at the time of his retirement, he would receive a monthly pension of $300.
>
> 2. *Flat Percentage of Compensation Per Year of Service:* "A participant's retirement benefit shall be 1% of his average compensation for each year of service to the employer." If an employee had thirty years of service at retirement and his average compensation for those thirty years was $10,000, his monthly pension would be $250 (30% times $10,000 divided by 12).[8]

Such formulae are generally used with large plans and will not be considered further in this article.

II. DEFINED CONTRIBUTION—NOT INTEGRATED WITH SOCIAL SECURITY

A defined contribution pension plan defines the contribution which the employer will make each year to the pension plan for its employees, also known as a "money purchase" plan. An employee's retirement benefit will depend upon: (1) the funds accumulated by employer contributions; (2) earnings on the funds; and (3) the employee's retirement age and sex.[9] As a rule of thumb, about $16,000 is required by an insurance company at retirement age 65 for a male in order to provide a pension of $100 per month for life with payments guaranteed for the first ten years if the participant dies within that period.

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6. McFarlane v. Hotz, 401 Ill. 506 at ___, 82 N.E.2d 650 at 656 (1948); Schlaefer v. Schlaefer, 122 F.2d 177, at 188 (1940); Letterman v. City of Tacoma, 53 Wash. 2d 294, 333 P.2d 650, at 653 (1958).

7. One aspect of such plans, that of maximum benefit allowed to participants, was changed by the 1974 Act. See addendum following article.

8. PENSION PLANNING at 38-39.

9. *Id.* at 33.

The usual formula states that a fixed percentage of the employee's compensation will be contributed each year. The contribution may be made either on base compensation or total compensation.[10]

In order to be a "qualified" plan, a pension plan must provide definitely determinable benefits.[11] A defined benefit plan meets this requirement automatically since the retirement benefit has been defined within the formula. Although this is not the case with a defined contribution formula, such a formula meets the "definitely determinable benefit" rule since the retirement benefit is determinable with reasonable accuracy, assuming a fixed contribution amount or percentage, a fixed earnings rate, and actuarial assumptions as to mortality.

III. Plans Integrated With Social Security

A. Defined Benefit

Integration of a pension plan means the coordination of the retirement benefits of a private pension plan with the retirement benefits provided by the Social Security Act. An employer may provide a greater level of benefits to those employees who earn in excess of "covered compensation." "Covered compensation" is defined as the amount of compensation on which old-age and survivors insurance benefits are based for an employee covered by the Social Security Act.[12] The Internal Revenue Service has prepared tables for determining a particular employee's covered compensation. One table specifies the covered compensation for each year on which an employee would reach his 65th birthday (Table II).[13] The other table, Table I, uses a bracket system and is more commonly used, as shown below:

TABLE I

Year of Birth	Calendar Year of 65th Birthday	Covered Compensation
1906 or earlier	1971	$5400
1907 to 1910	1972 to 1975	$6000
1911 to 1916	1976 to 1981	$6600
1917 to 1926	1982 to 1991	$7200
1927 to 1933	1992 to 1998	$7800
1934 to 1938	1999 to 2003	$8400
1939 or later	2004 or later	$9000

10. Maximum contribution, as well as maximum benefit allowed under this formula, also was changed by the 1974 Act. See addendum.

11. I.R.S. Reg. § 1.401-1(b)(1)(i); Rev. Rul. 65-178, pt. 2(m), CCH Pension Plan Guide ¶ 14,388.

12. Rev. Rul. 71-446, § 2.03, CCH Pension Plan Guide ¶ 14,913.

13. Rev. Rul. 71-446, § 3.02, CCH Pension Plan Guide ¶ 14,913.

The integration provisions do not violate the general principle of nondiscrimination in favor of the "prohibited group" (*i.e.* officers, shareholders, directors, supervisors, or high-paid employees) since the coordination of Social Security and private plan benefits produces a total retirement benefit which represents the same percentage of benefit to compensation for each employee. Since an employer contributes to the cost of the Social Security retirement benefit, it may contribute an additional amount for those employees with earnings in excess of "covered compensation." While the employee pays one-half of the assessed tax, an employee will not, in fact, bear half of the cost of his benefit until the Social Security program matures.[14]

Through a series of computations,[15] the Service has determined that an employer provides 37½% of an employee's retirement benefit under the Social Security program. Thus the employer could establish a plan which would provide a monthly pension benefit of 37½% of all earnings in excess of covered compensation. Any employee who earned less than covered compensation would not receive a pension from the plan.

Example: An employer has four employees with earnings and ages as follows:

TABLE I-A

Employee	Age	Year of Birth	Earnings	Covered Compensation
A	35	1938	$10,000	$8,400
B	40	1933	7,000	7,800
C	48	1925	10,000	7,200
D	60	1913	7,000	6,600

If the defined benefit formula is 37½% of all earnings in excess of covered compensation, the retirement benefit from the employer's plan would be as follows for each employee:

TABLE I-B

Employee	Annual Retirement Benefit
A	$600 (37½% of $1,600)
B	No Benefit
C	$675 (37½% of $1,800)
D	$150 (37½% of $400)

14. Pension Planning at 42-43, note 4 *supra*.

15. I.R.S. Reg. § 1.401-3(e)(2), CCH Pension Plan Guide ¶ 10,077.

If the defined benefit formula is 37 ½% of all earnings in excess of covered compensation plus 10% of total earnings, the retirement benefit for employees A, B, C, and D would be:

TABLE I-C

EMPLOYEE	EARNINGS	COVERED COMPENSATION	10% OF EARNINGS	37 ½% OF EXCESS	ANNUAL RETIREMENT BENEFIT
A	$10,000	$8,400	$1,000	$600	$1,600
B	7,000	7,800	700	----	700
C	10,000	7,200	1,000	675	1,675
D	7,000	6,600	700	150	850

The allowable maximum of 37 ½% assumes: (1) that there is no death benefit either before or after retirement; (2) that the normal retirement age is not before age 65, and (3) that an employee will have completed at least 15 years of service prior to his retirement.[16]

Pension plans often provide a pre-retirement death benefit in the form of life insurance and a post-retirement death benefit through an annuity having a ten year certain provision. If either of such benefits exists, the maximum allowable percentage is reduced by 10% to 33%. If both types of death benefits are provided, the maximum percentage is reduced to 30%.[17]

If an employee will have less than 15 years of service from the date of employment to the normal retirement age 65, his retirement benefit as determined on the excess portion is reduced by 1/15th for each year of service less than 15.[18] The reason for this reduction is based upon the Social Security Act. Under the Social Security Act, the old-age insurance benefit is reduced by 5/9 of 1% for each month less than 15 years between the date the individual (a worker) becomes entitled to the benefit and his age 65.[19] For example, if the individual were to retire at age 64, the social security retirement benefit would be reduced 5/9 of 1% times twelve months. This would equal a .06667 reduction of the retirement benefit. This percent figure, .06667, is the same as the fraction 1/15, and is the required reduction for an integrated defined benefit plan for each year of service less than fifteen from the date of employment to normal retirement age 65.

The Service allows integrated defined benefit plans to also de-

16. PENSION PLANNING at 43; Rev. Rul. 71-446, §§ 4 & 5, CCH PENSION PLAN GUIDE ¶ 14,913.

17. PENSION PLANNING at 44.

18. Rev. Rul. 71-446, § 10, CCH PENSION PLAN GUIDE ¶ 14,913.

19. *Medicare and Social Security Explained*, CCH PENSION PLAN GUIDE No. 72, Aug. 3, 1965, at 78.

fine compensation as either "total" compensation or "compensation less bonuses, overtime pay, or commissions" as long as discrimination in favor of the prohibited group does not result.[20] However, the local district offices will not issue an advance determination letter for small pension plans unless compensation is defined as "total" compensation since the prohibited discrimination could more easily occur.

If an employer establishes his pension plan under a master or proto-type plan, compensation will be defined as total compensation since the Service will not issue a ruling, determination letter, or opinion letter unless compensation is so defined. The principal reason is that the Service could not determine in advance whether in a particular plan a definition of compensation other than as "total" would result in the prohibited discrimination.[21] If less than total compensation is used as defining compensation for a particular integrated plan, the Service will consider the ratio of restrictive compensation to total. If this ratio is higher proportionately for highly compensated employees than it is for lower paid employees, discrimination in favor of the high paid employees is likely to result and the Service will consider the plan as unqualified.[22]

An employer may integrate a defined benefit plan at a level higher than the levels in Table I. In that event, the maximum percentage above the integrated level is proportionately reduced. The amount of the reduction will depend upon the maximum age selected under the plan at which an employee would be eligible to participate.[23] Almost all pension plans, especially defined benefit plans, specify a maximum age over which an employee would not be eligible to participate. For example, if the maximum age had been set at age 60, any employee who was over age 60 could not participate in the plan.

Once the maximum age has been determined and assuming the I.R.S. has no objection to it, the next step is to determine what the integration level would be for a present or future employee who might enter the plan at the maximum age selected, which in our example is age 60. An employee age 60 would have been born in 1913 and the integration level in that year under Table I is $6,600. This amount becomes the numerator in the necessary fraction used

20. Rev. Rul. 71-446, § 3.03, CCH PENSION PLAN GUIDE ¶ 14,913.
21. Rev. Proc. 69-20, CCH PENSION PLAN GUIDE ¶ 12,848.
22. Rev. Rul. 69-503, CCH PENSION PLAN GUIDE ¶ 14,697.
23. Rev. Rul. 71-446, § 5.04, CCH PENSION PLAN GUIDE ¶ 14,913.

to reduce the maximum integration percentage. If an employer wished to integrate his plan at $9,000, the maximum percentage would be 27% (37½ times 6,600/9,000).

The following table illustrates this result using the same employee information from above:

TABLE I-D

EMPLOYER	EARNINGS	27% OF EXCESS OVER $9,000	ANNUAL RETIREMENT BENEFIT
A	$10,000	$270	$270
B	7,000	---	---
C	10,000	270	270
D	7,000	---	---

The requirement of determining the maximum age at which a present or future employee would be eligible to participate was designed to prevent any discrimination that might result in favor of the prohibited group.

B. *Defined Contribution*

The basic rules for integration of a defined contribution plan are similar to those of a defined benefit plan. Revenue Ruling 71-446 allows a maximum percentage for contributions on the "excess" compensation above the integration level. The maximum allowable percentage on the excess is 7% and the maximum integration level is the current "taxable wage base."[24] The latter is defined by the Internal Revenue Service as: "with respect to any year, the maximum amount of earnings which may be considered wages for such year under section 3121(a)(1) of the Internal Revenue Code."[25] Section 3121(a)(1) is concerned with the current level of earnings which are subject to the Social Security tax. For the year 1973, the level is $10,800, which is therefore the maximum integration level.[26] This level applies to each employee regardless of age.

The following table illustrates these rules:

TABLE I-E

EMPLOYEE	EARNINGS	EXCESS OVER MAXIMUM LEVEL	ANNUAL CONTRIBUTION (7% OF EXCESS)
A	$40,000	$29,200	$2,044
B	30,000	19,200	1,344
C	20,000	9,200	644
D	10,000	- 0 -	- 0 -

24. Rev. Rul. 71-446, § 14, CCH PENSION PLAN GUIDE ¶ 14,913.
25. Rev. Rul. 71-446, § 2.04, CCH PENSION PLAN GUIDE ¶ 14,913.
26. The taxable wage base for 1974 is $13,200.

Although the current level of earnings subject to social security taxes is the maximum level of integration, an employer could elect to integrate at any level below maximum. If a level of $5,000 were elected, the following would result:

TABLE I-F

EMPLOYEE	EARNINGS	EXCESS OVER $5,000 LEVEL	ANNUAL CONTRIBUTION (7% OF EXCESS)
A	$40,000	$35,000	$2,450
B	30,000	25,000	1,750
C	20,000	15,000	1,050
D	10,000	5,000	350

In addition an employer could select an integration level above the maximum. In this situation the maximum allowable percentage on the excess is reduced according to the following formula.[27]

$$\frac{\text{Maximum Taxable Wage Base}}{\text{Dollar Amount Selected}} \times 7\% = \text{Maximum Allowable Percentage on Excess}$$

If a level of $20,000 were chosen, the maximum allowable percentage would be 4%, i.e. 10,800/20,000 x 7%, and the following would result:

TABLE I-G

EMPLOYEE	EARNINGS	EXCESS OVER 20,000 LEVEL	ANNUAL CONTRIBUTION (4% OF EXCESS)
A	$40,000	$20,000	$800
B	30,000	10,000	400
C	20,000	- 0 -	- 0 -
D	10,000	- 0 -	- 0 -

As with an integrated defined benefit plan, the definition of compensation must generally include total compensation to avoid discrimination in plan contributions or benefits for the highly compensated employees. However, there is no requirement for a minimum of fifteen years of service since a participant's retirement benefit is based solely on the accumulated funds.[28]

IV. ASSUMED RETIREMENT BENEFIT—WITH LEVEL ANNUAL CONTRIBUTION

An assumed benefit plan (often called a "target plan") represents a hybrid of a defined benefit and of a defined contribution

27. Rev. Rul. 71-446, §§ 6.04, 14.01, CCH PENSION PLAN GUIDE ¶ 14,913.
28. Goodman, Commentary, Oct. 5, 1961, CCH PENSION PLAN GUIDE ¶ 27,103.

plan. The plan operates as follows (assuming level annual contribution):

> 1. First, a projected retirement benefit is specified as a percentage of compensation, as, for example, ". . . an annual retirement benefit equal to 50% of the average compensation paid a participant during the last five years preceding his normal retirement date."
>
> 2. Once the projected retirement benefit has been determined, the employer's contributions are calculated on a level annual basis so that the required principal amount will have been accumulated at retirement.

Up to this point a target plan operates the same as a defined benefit plan. Under a defined benefit plan any earnings in excess of those "assumed" will be used to reduce the employer's next annual contribution. However, under a target plan the contribution level is not reduced by such excess earnings but remains constant throughout, except for variations in amounts of compensation of participants. In this respect it resembles a defined contribution plan. If the investment experience of the assets under the plan is greater than the assumed rate, the employee will have an actual retirement benefit greater than originally "assumed." If the investment experience is less than assumed, the retirement benefit will be correspondingly lower unless the employer has guaranteed as a minimum the assumed benefit level. In order to utilize the plan's fullest potential, the lowest permissible interest rate is assumed for calculating the employer's level contributions. The present rate acceptable by the Service ranges between 5% and 5 ½%. The target plan offers a greater anti-inflation hedge since all investment earnings will be shared by the plan participants.[29]

In order to facilitate the calculation of the annual contribution, most plans incorporate tables which show the percentage of an employee's compensation which must be contributed to fund the target benefit. Table A is such a table.[30]

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29. PENSION PLANNING at 41.

30. Reprinted with the permission of American City Bank & Trust Company, Milwaukee, WI. See Table A.

TABLE A

LEVEL PERCENTAGE OF COMPENSATION TO
PROVIDE TARGET BENEFIT OF 10% OF COMPENSATION
RETIREMENT AGE 65 - 10 YEARS CERTAIN AND LIFE ANNUITY

5½% ASSUMED INTEREST RATE

ENTRY AGE	PERCENT OF COMPENSATION	ENTRY AGE	PERCENT OF COMPENSATION
20	.54%	43	2.44
21	.58	44	2.64
22	.61		
23	.65	45	2.86
24	.69	46	3.11
		47	3.39
25	.73	48	3.70
26	.78	49	4.05
27	.83		
28	.88	50	4.46
29	.94	51	4.92
		52	5.46
30	1.11	53	6.09
31	1.06	54	6.85
32	1.13		
33	1.21	55	7.76
34	1.29	56	8.87
		57	10.27
35	1.38	58	12.08
36	1.47	59	14.50
37	1.58		
38	1.69	60	17.89
39	1.82	61	23.00
		62	31.52
40	1.95	63	48.59
41	2.10	64	99.85
42	2.26		

This table assumes a normal retirement age of 65, a 5½% interest return, and that the retirement benefit will be a life annuity and 10 years certain.

The following example illustrates the workings of this table based upon a target formula of 30% of compensation:

TABLE A-1

EMPLOYEE	AGE	EARNINGS	FACTOR	ANNUAL CONTRIBUTION
A	35	10,000	1.38% x 3	$ 414.00
B	40	7,000	1.95% x 3	409.50
C	48	10,000	3.70% x 3	1,110.00
D	60	7,000	17.89% x 3	3,756.90

Table B[31] represents a variation using different factors depending on whether the employee is male or female:

TABLE B

Level Percentage of Compensation to
Provide Target Benefit of 10% of Compensation
Retirement Age 65 — 10 Years Certain and Life Annuity

5½% Assumed Rate

AGE	MALES	FEMALES	AGE	MALES	FEMALES
Normal Retirement Age: 65					
	*15,873	*17,035			
18	.61%	.65%	43	3.07	3.29
19	.64	.69	44	3.32	3.56
20	.68	.73	45	3.60	3.86
21	.72	.78	46	3.91	4.19
22	.77	.82	47	4.25	4.56
23	.81	.87	48	4.64	4.98
24	.86	.93	49	5.09	5.46
25	.92	.99	50	5.60	6.00
26	.98	1.05	51	6.18	6.63
27	1.04	1.11	52	6.86	7.36
28	1.10	1.18	53	7.65	8.21
29	1.17	1.26	54	8.60	9.23
30	1.25	1.34	55	9.74	10.45
31	1.33	1.43	56	11.14	11.95
32	1.42	1.53	57	12.90	13.84
33	1.52	1.63	58	15.17	16.28
34	1.62	1.74	59	18.20	19.53
35	1.73	1.86	60	22.46	24.11
36	1.85	1.99	61	28.87	30.99
37	1.98	2.13	62	39.58	42.47
38	2.13	2.28	63	61.01	65.48
39	2.28	2.45	64	125.38	134.56
40	2.45	2.63			
41	2.64	2.83			
42	2.84	3.05			

*Capital sums required for annuity payable for life and guaranteed for ten years in event of death within such ten year period after retirement.

A comparison of these two tables demonstrates that Table B requires a greater contribution than Table A at the same ages. The

31. Reprinted with the permission of Emjay Corporation, Milwaukee, WI. See Table B.

reason for this difference is that Table B assumes a greater life expectance than Table A and therefore requires a greater accumulated amount at retirement age 65 in order to provide a life and ten years certain annuity. The following example reflects this variation under a 30% target formula:

TABLE B-1

EMPLOYEE	AGE	EARNINGS	FACTOR		ANNUAL CONTRIBUTION	
			MALE	FEMALE	MALE	FEMALE
A	35	10,000	1.73%x3	1.16%x3	$ 519	$ 558
B	40	7,000	2.45%x3	2.63%x3	514	552
C	48	10,000	4.64%x3	4.98%x3	1,392	1,494
D	60	7,000	22.46%x3	24.11%x3	4,716	5,063

As of this writing, the author is unaware of a target formula which integrates the retirement benefits with Social Security. The lack of integrated target plans appears to be caused by: (1) restrictions of the Internal Revenue Service and (2) the complexity of developing an acceptable table which would comply with the Service's requirements. However, the integration of a target plan (which would be subject to the integration rules for a defined benefit plan) could be accomplished in either of two ways.[32]

The first method is to prevent any earnings over the assumed rate of return from being credited to a participant's account. Such excess earnings would be used to reduce the employer's next annual contribution, as in a defined benefit plan.[33] This choice would completely eliminate the very reason for adopting a target plan, *i.e.* participation in earnings in excess of the assumed rate.

The second method is to provide that any earnings in excess of the assumed rate will be allocated among all participants in proportion to compensation.[34]

If a target formula provided for a benefit of 10% of total compensation plus an excess benefit of 37½% of all compensation in excess of covered compensation,[35] and the assumed interest rate of return was 5½%, this formula would presumably be acceptable to the Service if either of the following were provided in the plan:

1. Any earnings in excess of 5½%, which related to that part of the employer's contributions necessary to fund the excess benefit of 37½%, will be used to reduce the employer's next annual contribution for the excess benefit portion; or

32. Rev. Rul. 60-337, CCH PENSION PLAN GUIDE ¶ 14,290.

33. *Id.*

34. *Id.*

35. This formula assumes no death benefit before or after retirment, normal retirement age of 65, and a 15 years of service requirement before retirement for a full benefit.

2. Any excess earnings will be allocated among all participants in proportion to total compensation.

Either alternative would apparently complicate the preparation of tables and of a formula itself which would be acceptable by the Service. However, as target plans become more popular, it is likely that the necessary tables and formulae will be developed to permit integration with Social Security benefits.

CONCLUSION

Whether an employer should use a defined benefit formula (integrated or not), a defined contribution formula (integrated or not) or an assumed retirement benefit formula, will depend upon each employer's particular situation. The ages and compensation of employees, the ability of the employer to make contributions to a plan, the requirements of the Internal Revenue Service and many other factors must be reviewed in order to select a formula which will best accomplish the employer's objectives. It is important that attorneys understand the nature of the formulae available in order to adequately represent and advise their corporate clients.

ADDENDUM

The preceding article was prepared and submitted to the printers prior to enactment of the Pension Reform Act of 1974. The new act affects the article in two areas, which are:

1. Maximum benefit allowed under a defined benefit plan.
2. Maximum contribution allowed under a defined contribution plan and under a target plan.

The maximum annual retirement benefit which can be provided under a defined benefit plan is the lesser of (1) $75,000 or (2) 100% of the participant's average compensation for the highest three consecutive calendar years during which he was an active participant under the plan.[1] The type of retirement benefit to which the limits apply is a straight life annuity with no ancillary benefits. New regulations will describe the necessary adjustments to be made if other than a straight life annuity is selected as the payout of the retirement benefit or if ancillary benefits are provided. Also if the retirement benefit commences before age 55 or if an employee has less than 10 years of service, adjustments are necessary as will be prescribed by the new regulations.[2]

However a minimum annual benefit of $10,000 or less can always be paid without limitations.[3]

The maximum annual addition to a participant's account in a defined contribution plan is the lesser of (1) $25,000 or (2) 25% of the participant's compensation.[4] This maximum annual addition consists of:

1. Employer contributions, and
2. The lesser of
   (a) one-half of the employee's contributions, if any, or
   (b) all of the employee's contribution in excess of 6% of his compensation, and
3. Forfeitures.

Target benefit plans must comply with the same limitations applicable to defined contribution plans.[5]

The above limitations are effective for all plan years in which

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1. Pension Reform Act of 1974 Sec. 2004(a)(2) adding Code Sec. 415 (b)(1) and (3).
2. Pension Reform Act of 1974 Sec. 2004(a)(2) adding Code Sec. 415(b)(2) and (5).
3. Pension Reform Act of 1974 Sec. 2004(a)(2) adding Code Sec. 415(b)(4).
4. Pension Reform Act of 1974 Sec. 2004(a)(2) adding Code Sec. 415(c).
5. Congressional Committee Reports, CCH Pension Plan Guide Number 316, ¶ 5082.

contributions are made or benefits accrued beginning after December 31, 1975.[6]

The foregoing is a brief outline of those parts of the Pension Reform Act which affect the content of the preceding Article.

The new Act contains so many revisions of the prior law that probably every qualified retirement plan will have to be amended in order to comply with the Act's requirements.

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6. *Id.*